ST 02-20
Tax Type: Sales Tax
Issue: Tangible Personal Property for Rental Purposes

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS v.	)	**Docket #**	**98-ST-0000**
ABC RENTALS, INC.	)	**IBT #**	**0000-0000**
	)	**NTL #**	**00-000000000000000**
	)		00-**000000000000000**
ABC RENTALS II, INC.	)	**IBT #**	**0000-0000**
	)	**NTL #**	**00-000000000000000**
	)		**00-000000000000000**
ABC RENTALS III, INC.	)	**IBT #**	**0000-0000**
	)	**NTL #**	**00-000000000000000**
	)		**00-000000000000000**
ABC RENTALS IV, INC.	)	**IBT #**	**0000-0000**
Taxpayers	)	**NTL #**	**00-000000000000000**
	)		**Barbara S. Rowe**
	)		**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Michael A. Kraft of Quinn, Johnson, Henderson & Pretorius for ABC Rentals, Inc., ABC Rentals II, Inc., ABC Rentals III, Inc., and ABC Rentals IV, Inc.; Mr. Charles Hickman and Mr. Kent Steinkamp, Special Assistant Attorneys General for the Illinois Department of Revenue.

Synopsis:

This matter arose on the timely protest of ABC Rentals, Inc., ABC Rentals II, Inc., ABC Rentals III, Inc., and ABC Rentals IV, Inc. (hereinafter collectively referred to as the "Taxpayers") to Audit Corrections and/or Determinations of Tax Due issued by the Illinois Department of Revenue (hereinafter referred to as the "Department") for Retailers' Occupation and Use Tax liabilities asserted by the Department. The liabilities established were for various

periods, depending upon which entity was involved. The basis of the liabilities was for vehicle purchases and equipment supply purchases of each of the taxpayers.

Taxpayers aver that they are automobile dealers and as such did not pay Use Tax, 35 **ILCS** 105/1 *et seq.* (hereinafter referred to as "UT") when they purchased trucks, trailers, automobiles, and vans for use as rental vehicles. Taxpayers claim at hearing that the rental use of their vehicles was an interim use, therefore, the interim and demonstration use exemption from the imposition of UT is appropriate. However, taxpayers also assert they are not responsible to pay the Retailers' Occupation Tax, 35 **ILCS** 120/1 *et seq.* (hereinafter referred to as the "ROT") on their sales of those vehicles.

In contrast to taxpayers' claims, the Department asserts that taxpayers' business is not primarily as sellers of motor vehicles, but rather, that taxpayers are in the business of renting motor vehicles. In fact, taxpayers were registered for and were paying tax under the Automobile Renting Occupation and Use Tax Act 35 **ILCS** 155/1 *et seq.* (hereinafter referred to as the "ART"). Therefore, the Department made a number of adjustments to taxpayers' liabilities to the Department. The first adjustment made by the Department's auditor is for ROT on vehicles that came out of taxpayers' rental fleet and were sold. The second adjustment made is for UT on trucks, trailers, and vans that taxpayers purchased without paying tax. The third adjustment made is for UT for maintenance and repair parts for those vehicles. The final adjustment made is for UT on consumable supplies, primarily oil and antifreeze.

Taxpayers assert they should not pay UT on their purchase of the automobiles and should not be responsible for the payment of the ROT on the subsequent sale of those cars. There is a statutory exemption from the imposition of UT when an automobile rental agency purchases a car for rental[1] and there is an exemption from the payment of UT when a car dealership

[1] 35 **ILCS** 105/3-5

purchases an automobile for resale[2]. Under neither statutory provision is there an exemption from the collection of UT[3] and the remittance of ROT when the automobile is sold.

The primary issue is whether taxpayers are in the business of selling motor vehicles or in the business of renting automobiles with some sales occurring. A second and related issue is whether the purchases by taxpayers of trucks, trailers, vans, parts, and supplies were exempt from ROT or UT under the interim or demonstration use exemption. An additional issue is whether ROT is owed on the sale of the rental cars after they were used for rental.

Further, the Department supplied information to taxpayers regarding UT paid to the Department by taxpayers' customers when the vehicles were registered and titled with the Secretary of State of Illinois. The Department asserts that taxpayers are not entitled to a credit for those taxes because they were not paid by taxpayers.

After a thorough review of the facts and law presented, it is my recommendation that the Notices of Tax Liability be upheld in their entirety with adjustments made for the taxes paid by taxpayers' customers. In support thereof, I make the following findings and conclusions in accordance with the requirements of Section 100/10-50 of the Administrative Procedure Act (5 **ILCS** 100/10-50).

FINDINGS OF FACT:

1. The *prima facie* case of the Department was established by the admission into evidence of the Notices of Tax Liability issued to taxpayers. (Tr. p. 42)

2. The Department audited the taxpayers and established both pre- and post-Uniform Penalty and Interest Act (hereinafter referred to as "UPIA") liabilities. The pre- UPIA period ends on November 30, 1993. (Dept. Ex. Nos. 1-6, 8-13, 15-20, 22-26; Tr. pp. 15-21, 32)

3. Taxpayers were not registered for ROT and UT purposes with the Department

[2] 35 **ILCS** 120/2c
[3] The UT that is statutorily mandated to be collected by a retailer from its customer is commonly referred to as the sales tax.

prior to the audit. Taxpayers were registered and filing returns and paying tax under the ART for rental tax on vehicles rented. (Tr. pp. 15-21)

4. The Department's auditor prepared a global taxable exceptions list for each of the taxpayers. The list is of liabilities on transactions where tax is due and has not been paid. The auditor's global taxable exemptions for the taxpayers list individual car sales for which no tax was paid; equipment for which tax was not paid; truck and trailer purchases for which no tax was paid; vehicle parts and accessories for which no tax was paid; and vehicle lubricants for which no tax was paid. The exceptions were for both ROT and UT. The audits of the four taxpayers were conducted simultaneously. (Dept. Ex. Nos. 1-6, 8-13, 15-20, 22-26; Tr. pp. 15-21, 32)

5. The four taxpayers are separate and distinct corporations that at the time of the audit shared centralized policies and services including, accounting, payroll, tax work, and purchasing of some goods. (Tr. pp. 71-75)

6. Taxpayers' policies and procedures for purchasing vehicles and purchasing repair parts, maintenance items, and other items at issue were identical during the audit period. (Tr. pp. 74-75)

7. Taxpayers typically purchase new cars and then sell some of them at a later date. The normal pattern of taxpayers' business is to use a vehicle for rental as long as it is serviceable and then sell it. The cars are three to five years old when sold. (Taxpayers' Ex. No. 1, p. 18 (discovery deposition of John Doe, CPA); Dept. Ex. No. 4 (auditor's global taxable exceptions); Tr. pp. 109-110)

8. Taxpayers are not licensed automobile dealers. (Tr. pp. 67, 94)

9. Taxpayers did not collect any UT when they sold a vehicle. (Tr. p. 105)

10. Taxpayers did not remit any ROT based upon the sale of any vehicle. (Tr. p. 105)

10. Taxpayers purchase vehicles ranging from small compact cars to full-size pick-up trucks, vans, and trailers. Taxpayers purchase the motor vehicles in large quantities and then allocate the vehicles as needed by the individual corporations. (Tr. pp. 75-76)

11. The majority of taxpayers' business is to provide replacement vehicles for insurance companies. The cars, trucks, vans, and trailers are needed because an insurance company's client has a vehicle that has been destroyed or is being repaired. (Tr. pp. 77-78)

12. The president and founder of taxpayers was in the insurance field prior to founding these corporations. (Tr. pp. 103-104)

13. Taxpayers concede that they have never been in the car sales business. (Tr. p. 103 (testimony of Mr. Joe Blow, taxpayers' owner and founder))

14. Taxpayers maintain an inventory of vehicles on a regular basis. They depreciate the inventory. (Tr. p. 103)

15. Taxpayers place fliers inside the vehicles and attach them to rental contracts that state "Vehicles from our fleet are FOR SALE. We have one-owner rental/lease vehicles for sale." (Taxpayers' Ex. Nos. 5, 6; Tr. pp. 78-80)

16. Some sales of vehicles to rental customers occur. (Tr. p. 92)

17. When taxpayers sell a vehicle to a third party purchaser, a bill of sale is created and taxpayers photocopy the title. Taxpayers transfer the title and apply for the license plates. Taxpayers do not collect sales tax from the third party purchasers of the vehicles. (Tr. pp. 81-82)

18. If one of taxpayers' vehicles is involved in an accident, taxpayers purchase the repair parts or maintenance items. (Taxpayers' Ex. No. 1 p. 8)

19. On May 11, 1998, the Department issued an Audit Correction and/or Determination of Tax Due to ABC Rentals, Inc. (hereinafter referred to as "ABC") located in Peoria, Illinois for Retailers' Occupation and related taxes for July 1, 1981 through December 1, 1997 in the tax amount of $84,269.00. (Dept. Ex. No. 1; Tr. pp. 15-28)

20. The auditor's global taxable exceptions for ABC show sales of 21 cars by ABC in 1988. ABC sold 211 cars plus "various vehicles" during the entire audit period. (Dept. Ex. No. 4; Taxpayers' Ex. No. 3)

21. On May 11, 1998, the Department issued an Audit Correction and/or Determination of Tax Due to ABC Rentals II, Inc., (hereinafter referred to as "ABC II") located in Springfield, Illinois for Retailers' Occupation and related taxes for May 1, 1984 through December 1, 1997 in the tax amount of $36,180.00. ABC II sold 71 vehicles during the audit period. (Dept. Ex. Nos. 8-13; Tr. pp. 29-34)

22. On May 11, 1998, the Department issued an Audit Correction and/or Determination of Tax Due to ABC Rentals III, Inc., (hereinafter referred to as "ABC III") located in Rock Island, Illinois for Retailers' Occupation and related taxes for January 1, 1983 through December 31, 1997 in the tax amount of $21,972.00. ABC III sold 35 automobiles during the audit period. (Dept. Ex. Nos. 15-20,Tr. pp. 34-38)

23. On May 20, 1998, the Department issued an Audit Correction and/or Determination of Tax Due to ABC Rentals IV, Inc., (hereinafter referred as "ABC IV") located in Peoria, Illinois for Retailers' Occupation and related taxes for March 1, 1996 through December 31, 1997 in the tax amount of $4,682.00. As ABC IV is a relatively new company it had no vehicle sales. The liability established is for fixed assets and maintenance parts. The auditor's projection for ABC IV was based upon a detailed examination of the portion of its 1995 fiscal year, ending on August 31, 1996. (Dept. Ex. Nos. 22-26; Tr. pp. 38-42)

24. The Department's auditor performed a detailed analyses on taxpayers using books and records when available. For the time periods where records were unavailable, taxpayers' federal returns for vehicle sales were consulted. For the non-vehicle transactions, such as maintenance parts and oil, generally a two-year period was analyzed and then projected over the six-year audit period for those items. The auditor chose the sample years based on the time periods that the most records were available. The samples chosen were taxpayers' fiscal years 1993 and 1995. The auditor took the figures from taxpayers' general ledgers. The individual invoice for each transaction was not always available; however, the general ledgers had a very detailed break out of the sellers. The audit periods were slightly different for each taxpayer because of either the date of the company's formation or the statute of limitations for the parts

and related items. (Dept. Ex. Nos. 6, 13, 20, 26; Tr. pp. 20-21, 24, 33-36, 50-51, 55, 60-64)

25. At hearing, taxpayers produced documents and invoices of their customers that show tax was paid on some of the transactions listed on the auditor's global exceptions. According to the documents produced, the total amount of tax paid by customers when they registered vehicles purchased from taxpayers with the State of Illinois was $22,425.66. (Taxpayers' Ex. Nos. 3, 4)

26. At the audit level the Department allowed ABC a credit of $643.13 for sales tax paid by its customers on cars sold. The auditor also allowed ABC II a credit of $156.25 at the audit level for sales tax paid by a customer for one of the cars it sold. The total credit allowed for the two taxpayers was $799.38[4] at the audit level. According to the documents and invoices produced during discovery in this matter, the total tax amount paid by customers of ABC, ABC II, and ABC III is $22,425.66. Therefore, the remaining amount of possible credit for tax paid by customers for the vehicles at issue is $21,626.28. (Taxpayers' Ex. Nos. 3, 4; Dept. Ex. Nos. 4, 11, 18; Tr. pp. 7-12)

CONCLUSIONS OF LAW:

Taxpayers were registered and paid tax to the Department pursuant to the Automobile Renting Occupation and Use Tax Act (hereinafter referred to as the "ART"). This act imposes a tax on "persons engaged in this State in the business of renting automobiles in Illinois at the rate of 5% of the gross receipts received from such business." 35 **ILCS** 155/3.

The Use Tax Act (hereinafter referred to as the "UTA") at 35 **ILCS** 105/3-5, states that "[U]se of the following tangible personal property is exempt from the tax imposed by this Act":

> A motor vehicle of the first division, a motor vehicle of the second division that is a self-contained motor vehicle designed or permanently converted to provide living quarters for recreational, camping, or travel use, with the direct walk through to the living quarters from the driver's seat, or a motor vehicle of the second

[4] The Department's representative incorrectly testified that this amount is $799.28. (Tr. p. 11)

> division that is of the van configuration designed for the transportation of not less than 7 nor more than 16 passengers, as defined in Section 1-146 of the Illinois Vehicle Code[5] that is used for automobile renting, as defined in the Automobile Renting Occupation and Use Tax Act.[6] 35 **ILCS** 105/3-5(10)

The Retailers' Occupation Tax Act (hereinafter referred to as the "ROTA") also contains the automobile renting exemption at 35 **ILCS** 120/2-5.

As entities registered with the State under ART, taxpayers properly did not pay UT when they purchased rental cars. Thus, by their own actions taxpayers defined themselves as in the business of automobile rental.[7]

Taxpayers' purchases of the trailers, trucks, and repair parts

Taxpayers assert that the trucks, trailers, and repair parts at issue are also exempt from taxation under 35 **ILCS** 105/3(10) and 35 **ILCS** 120/2-5. A claimant must prove clearly and conclusively its entitlement to an exemption. Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455 (2nd Dist. 1995) *rehearing denied; leave to appeal denied* (164 Ill.2d 585), Telco Leasing, Inc. v. Allphin., 63 Ill.2d 305 (1976) Further, in ascertaining whether or not a property is statutorily tax exempt, the burden of establishing the right to the exemption is on the one who claims the exemption. Midway Airlines, Inc. v. Department of Revenue, 234 Ill.App.3d 866 (1st Dist. 1992) *leave to appeal denied* (146 Ill.2d 632) Statutes granting such privileges are to be strictly construed in favor of taxation. Telco at 310

While passenger automobiles are exempt from the imposition of UT when purchased for the purpose of automobile rental, there is no mention in either the UTA or ROTA exemption about trucks, trailers, or repair parts used on those automobiles. Taxpayers supplied no authority to sustain the assertion that UT does not apply to the purchase of taxpayers' trucks, trailers, and repair parts. Further, in John Nottili, Inc. v. Illinois Department of Revenue, 272 Ill.App.3d 822

[5] 625 ILCS 5/1-146
[6] 35 ILCS 155/1 ET SEQ.
[7] A more complete discussion of taxpayers as automobile renters appears, *infra*, under "Sales of rental cars by rental agencies".

(4th Dist. 1995) the court discusses the applicability of the imposition of the ART to various vehicles. The court states specifically that "*Truck* rentals are not subject to the Act." *Id.* at 823. Therefore, the purchases of those items are not tax exempt under ART, and the imposition under the ROTA or UTA of tax for the trucks, trailers, and repair parts is proper.

Sales of rental cars by rental agencies

Taxpayers were registered and paid tax to the Department as being in the occupation of automobile renting. Taxpayers' name incorporates the word "rental". The ROTA and UTA contain provisions regarding persons engaged in the business of automobile rental and their obligations when selling cars. The provisions, found at 35 **ILCS** 105/1a and 35 **ILCS** 120/1c state:

> A person who is engaged in the business of leasing or renting motor vehicles to others and who, in connection with such business sells any used motor vehicle to a purchaser for his use and not for the purpose of resale, is a retailer engaged in the business of selling tangible personal property at retail under this Act to the extent of the value of the vehicle sold.

The rules promulgated by the Department in conjunction with the ART state that:

> Any person who habitually engages in renting automobiles under lease terms of one year or less, or who, in any manner or at any time, advertises, solicits, offers for rent or holds himself out to the public to be a rentor of automobiles under lease terms of one year or less is engaged in the business that is taxed by the Act, provided that such person is engaged in such business in this State. 86 Admin. Code ch. I, Sec. 180.115.

The Certified Public Accountant (hereinafter "CPA") employed by taxpayer in 1991 stated at his deposition[8] that taxpayers' businesses are the "rental, short-term rental of vehicles somewhat oriented to the insurance area." "The normal pattern of taxpayers' business is the

[8] The discovery deposition of John Doe, CPA, engaged in public accounting, was admitted into evidence. (Taxpayers' Ex. No. 1) The Department stipulated to its admissibility into evidence. (Tr. p. 6) The Department attended the deposition but asked no questions. (Taxpayers' Ex. No. 1, p. 19) The CPA did the accounting and tax work for ABC, ABC II, and ABC III for 14 years. (Taxpayers' Ex. No. 1, pp. 4-6)

vehicles are used for a certain number of years, as long as they were serviceable. And I can't remember if there was a fixed time period as to when they made a decision to turn it over and sell it at any point in time, but that was the understanding, that they would be sold at some kind of future date." (Taxpayers' Ex. No. 1, pp. 7, 18) In addition, the CPA agrees that sales tax is owed on the purchase price of replacement parts installed in taxpayers' vehicles that had been damaged in accidents. (Taxpayers' Ex. No. 1, pp. 15-16)

The president and founder of the four companies herein, Joe Blow, testified that Doe was advised of the operation and business of the taxpayers and the CPA was quite familiar with the business that was transacted. (Tr. pp. 87-88) Blow also admits that taxpayers have never been in the car sales business. (Tr. p. 103) The cars at issue are kept for three to five years and then sold. Taxpayers' president also testified that he believed that taxpayers were properly registered under ART as being in the business of renting automobiles. (Tr. p. 85)

Based upon the testimony of taxpayers' CPA, and the president and founder of taxpayers, taxpayers were clearly in the business of renting motor vehicles during the audit period. Therefore, by statute, as renters of automobiles, taxpayers are obligated to collect UT from the customers to whom taxpayers sell the rental cars.

Taxpayers' liabilities under the ROTA and UTA

The Department issued Audit Corrections and/or Determinations of Tax Due to each of the taxpayers and admitted those into evidence at the hearing. Such corrected returns are *prima facie* evidence of the correctness of the amount of tax due as shown on the returns. The burden then shifts to the taxpayer to prove with competent evidence that the Department's assessment is incorrect. Soho Club, Inc. v. Department of Revenue, 269 Ill.App.3d 220 (1st Dist. 1995) The taxpayer has a duty to maintain books and records as required by the statutes and the Department's regulations. A taxpayer's oral testimony, without corroborative evidence, is insufficient to rebut the Department's *prima facie* case. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826 (1st Dist 1988) The burden is on the taxpayer to produce competent evidence identified by its books and records showing that the Department's determinations are

incorrect. Quincy Trading Post, Inc. v. Department of Revenue, 12 Ill.App.3d 725 (4th Dist. 1973)

Under the applicable UTA and ROTA provisions, an automobile dealer, as a retailer, is responsible for the tax on the sale of the automobile that was used by it prior to the sale. 35 **ILCS** 105/1a; 35 **ILCS** 120/1c. Taxpayers argue that since they sell some cars, they qualify for the interim use exemption under the UTA. 35 **ILCS** 105/2 Taxpayers also argue that since they were not licensed automobile dealers, they are not subject to the imposition of the ROT as are licensed automobile dealers, but are still entitled to the interim use exemption as retailers. By advancing this argument, in effect, taxpayers conclude that they can avoid the imposition of the UT on the purchase of the cars that they rent and then sell, as well as ROT on the subsequent sale of the vehicles.

The economic value considerations behind the interplay of the UTA, the ART, and the ROTA indicate that the exemption cannot be interpreted to allow cars to be sold free of the sales tax after their use as rental cars, whether the taxpayer's primary business is as an automobile renter or dealer. The tax imposed under ART each time the automobile is rented, is designed to tax the partial payoff of its value to the business, such that any residual value in the vehicle is assigned at the time of its subsequent sale. This is clear from the statutes at 35 **ILCS** 120/1c and 35 **ILCS** 105/1a wherein the sale of a rental vehicle by a taxpayer engaged in the rental business is deemed a sale at retail. Therefore, taxpayers cannot evade their responsibilities to collect sales tax and remit it to the State under those provisions, and in fact, provide no authority for taxpayers' reading of the pertinent statutory provisions to support their positions that no UT or ROT applies to them. There is simply no question that when taxpayers sold their rental automobiles, they were required to collect UT from their customers and remit it as their ROT liability.

Taxpayers advance the argument that as unlicensed automobile dealers, they are not required to collect and remit ROT on the sales of the used cars. They also argue that despite being registered as such, they are not automobile rental agencies and therefore are not required to

remit ROT on the sales of their rental cars. According to the statutes, when a retailer sells tangible personal property, ROT is due on the sale unless an exemption applies. 35 **ILCS** 120/2 There is an exemption from the imposition of use tax when an automobile rental agency purchases a car for rental, 35 **ILCS** 120/2-5(5) and there is a use tax exemption when a car dealership purchases an automobile for resale, 35 **ILCS** 120/2c. However, under neither statutory provision or scenario advanced by taxpayers is there an exemption when the automobile is sold. Taxpayers have supplied no authority to substantiate the assertion that those transactions are exempt.

The interim and demonstration use exemption applicable to automobile retailers

The UTA imposes a tax upon the use of tangible personal property purchased from a retailer. 35 **ILCS** 105/3 The UTA defines:

> "Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property,
>
> * * *
>
> "Use" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property. 35 **ILCS** 105/2

An alternate argument asserted by taxpayers regarding an exemption for tax on the trucks, trailers, cars, and repair parts at issue is that they qualify for exemption under the definition of use that provides that demonstration or interim use is not taxable under the UTA. Since the repair parts are incorporated into cars sold by taxpayers, they assert there should be no tax due when they purchase those parts. They argue that the use of the cars, trucks, and trailers as rental vehicles is only a demonstration or interim use and therefore also not taxable.

In order to qualify for the type of use that is exempt from tax under 35 **ILCS** 105/2, the use must be for "demonstration or interim purposes" and must be "by a retailer before he sells that tangible personal property." Regarding the issue of whether taxpayers are retailers under this section, Illinois statutes require that new and used automobile dealers must be licensed. 625 **ILCS** 5/5-102 states:

> (a) No person, other than a licensed new vehicle dealer, shall engage in the business of selling or dealing in, on consignment or otherwise, 5 or more used vehicles of any make during the year (except house trailers as authorized by paragraph (j) of this Section and rebuilt salvage vehicles sold by their rebuilders to persons licensed under this Chapter) or act as an intermediary, agent or broker for any licensed dealer or vehicle purchaser (other than a salesperson) or represent or advertise that he is so engaged or intends to so engage in such business unless licensed to do so by the Secretary of State under the provisions of this Section.

There is no evidence that taxpayers attempted to become licensed as used car dealers as is legally required. Rather, what was presented was a copy of the transcript of the deposition of an investigator for the Secretary of State[9] wherein the investigator determined that ABC did not need to be licensed as an automobile dealer in 1988. A reading of this deposition transcript sheds little if any light on what information was provided to the inspector. As a result, no value can be given to this evidence.

Despite what the law requires, taxpayers were not licensed car dealers in 1988 nor in any subsequent year. It is a taxpayer's responsibility to find out what laws govern its business. Taxpayers failed to refute the Department's assertion regarding the amount of cars sold, therefore, taxpayers' failure to comply with Illinois law cannot be excused.

In a rather confusing argument, however, even though taxpayers are not licensed dealers, they still assert they are retailers and are entitled to the interim and demonstration use exemption from the imposition of use tax on their motor vehicle purchases. In support of this argument taxpayers rely upon a number of decisions. L & L Sales and Services, Inc. v. The Department of Revenue 68 Ill.App.3d 329 (4th Dist. 1979) involves a business that sells heavy construction equipment at retail and also leases the equipment with or without an operator. For the period in question, about 29% of the gross revenue of L & L came from leasing and construction. All of the equipment had been kept in L & L's inventory and no depreciation had been taken on it. Most was later sold with sales tax paid based upon the sales price. An operator was furnished by L & L when the equipment was used in construction. All of the equipment had been purchased

[9] The Department stipulated and agreed to the admission of this discovery deposition into evidence. (Tr. pp. 6-8)

with the intent of reselling it, but because of the slowdown in the construction industry, L & L got into the business of renting in order to be able to finance its inventory of heavy equipment. The leasing also helped generate sales of the equipment. The Fourth District Illinois Appellate Court, citing Illinois Road Equipment Co. v. Department of Revenue, 32 Ill.2d 576 (1965), states:

> "[A]t no time was any of the machinery here involved held by either plaintiff for any ultimate purpose other than a sale at retail, and the practice of renting on a trial or promotional basis is in no way inconsistent with that purpose. [cites omitted] On the facts of these cases we think that the practice of renting machinery is either a use for demonstration or an interim use by a retailer prior to sale, both of which uses are expressly excluded from the definition of a taxable 'use' by the Use Tax Act." *Id.* at 331

That court continued, "Plaintiff's practice of accounting for the equipment as inventory and not depreciating it is consistent with a continued intent to ultimately sell it at retail." *Id.* at 332 The court held that the interim use by L & L came within the exception of section 2 of the UTA.

In contrast, taxpayers herein did depreciate the rental automobiles. Taxpayers held the vehicles for rental for periods of three to five years before selling them. Therefore, taxpayers have not established that the purpose for purchasing the vehicles was for sale. I find the facts in L & L distinguishable from the facts at bar, and therefore not applicable.

In Weaver-Yemm Chevrolet v. Director, Department of Revenue, 87 Ill.App.3d 83 (3rd Dist. 1980), also relied upon by taxpayers, the issue was whether the use of cars by the children of the owners of Weaver-Yemm Chevrolet and the use of trucks by service department personnel constituted interim uses. The court concluded those uses were interim and exempt from the tax act. In so finding, the court stated:

> In the instant case, the cars and trucks owned by Weaver-Yemm Chevrolet and used, respectively, by children of the owners and the service department, were not used to promote sales, nor did their use constitute a leasing. . . . We are of the opinion that the use to which the vehicles in the instant case were put is an interim use and exempt from use tax. The vehicles were purchased by Weaver-Yemm Chevrolet with the intent of selling them at retail. This intent to ultimately sell at retail continued while

> the vehicles were being used by the children of Weaver-Yemm's owners and by the service department. There was no ultimate purpose for the vehicles other than a retail sale, and we do not consider the use of the vehicles in the instant case to be inconsistent with that purpose." *Id.* at 85-86

In Weaver-Yemm, as in L & L, there was no question that the taxpayers were in the retail business of selling cars. In fact in L & L only 29% of gross income came from its leasing and construction operation. Similarly, in Illinois Road Equipment Co. v. Department of Revenue 32 Ill.2d 576 (1965), less than 1% of Illinois Road's gross income was from rent received. Taxpayers herein failed to establish, with evidence closely associated with their books and records, that income from sales of vehicles exceeds the income from their automobile rental. Taxpayers have failed to establish that they are in the business of selling motor vehicles.

Illinois Road Equipment Co. v. Department of Revenue, *supra* is the seminal case regarding the distinction between rental versus demonstration or interim use of tangible personal property prior to sale. Illinois Road involved two retail sellers of heavy construction equipment who periodically leased machinery to prospective buyers. The Supreme Court held that the UTA was not intended to impose a tax on the practice of renting property held for eventual sale and was not applicable to the leases. The court stated: "There is further evidence that plaintiff retained no machinery for the primary purpose of rental, and during the years here involved the amount of rent received averaged less than one percent of plaintiff's annual gross income." *Id.* at 578

The other seller of heavy construction equipment involved in Illinois Road similarly rented out some of its equipment to prospective purchasers for rental periods of short duration. In many instances machines were sold to the customer that originally rented them, although there were times when the machine was returned because it was not appropriate for the given job or the customer had financial difficulties. When a machine was returned, the seller collected the rent and then attempted to sell the machine to another buyer. The court stated "[I]t is undisputed that all of the machinery in plaintiff's inventory was held for sale and none for the primary

purpose of rental." *Id.* at 579 The court went on to say:

> We are of the opinion that the Use Tax Act was not intended to impose a tax on the practice of renting employed by both plaintiffs in these cases. The act provides that a tax is imposed upon "the privilege of using in this State tangible personal purchased at retail * * * from a retailer." . . . . The evidence established that the act of renting machinery was in each case simply a method used by plaintiffs to demonstrate and promote the sale of the machinery and was not a separate and distinct enterprise from the business of selling the machinery at retail. At no time was any of the machinery here involved held by either plaintiff for any ultimate purpose other than sale at retail, and the practice of renting on a trial or promotional basis is in no way inconsistent with that purpose. *Id.* at 579-580

The cases relied upon by taxpayers in support of their argument are easily distinguishable from the instant matters, including the fact that the time frame for which the vehicles were used for demonstration or interim use in the cases was much shorter than the three to five years that these taxpayers used the rental vehicles before selling them. The facts in each of those cases establish that there was no question that the taxpayer therein was a retailer in the business of selling tangible personal property.

One of the issues herein is whether taxpayers are in fact motor vehicle retailers. Taxpayers' president and founder was in the insurance business prior to founding the businesses. His testimony was that when taxpayers rent the vehicles to customers they have the "intent" to sell the vehicles as well. (Tr. p. 92) Sometimes that happens. The fact that this happens only sometimes and that it is only a "hope" negates the assertion that taxpayers are in the business of selling cars. In fact, the president of taxpayers admits that taxpayers have never been in the car sales business. (Tr. p. 103) Therefore, the interim and demonstration use exemption applicable to automobile retailers does not apply to taxpayers.

Furthermore, the interim or demonstration use exemption only permits the dealer to be exempt from paying the UT to its vendor on its purchase of the vehicle. The dealer is still required to collect the UT from its purchaser of that demonstration car and to remit it as its own

ROT obligation. Taxpayers herein appear to claim that the interim use exemption relieves them from not only their own UT obligation as purchasers, but, also, from ROT obligations as retailers. Taxpayers are incorrect in this claim.

Taxpayers as retailers

Part of the Department's assessments in these matters results in the imposition of ROT measured by the sales price of the motor vehicles that taxpayers eventually sold. The ROTA and UTA provide for such assessments specifically. The provisions, found at 35 **ILCS** 105/1a and 35 **ILCS** 120/1c state:

> A person who is engaged in the business of leasing or renting motor vehicles to others and who, in connection with such business sells any used motor vehicle to a purchaser for his use and not for the purpose of resale, is a retailer engaged in the business of selling tangible personal property at retail under this Act to the extent of the value of the vehicle sold. (emphasis added)

While the statutory language cited above imposes the obligation to collect tax on sales of motor vehicles that had been previously used in a leasing or rental business, the language also limits the definition of the retailer as used in that provision as being a retailer "to the extent of the value of the vehicle sold." Therefore it does not make a person who is engaged in the business of leasing or renting a retailer *per se* under the tax acts.

These tax provisions dictate how the tax is to be calculated when an automobile renter sells a rental vehicle. Further as there is a specific direction as to the calculation, it is clear that the acts do not intend for an entity to evade liability by claiming an exemption to this tax.

Taxpayers herein were registered with the Department to collect and pay automobile rental tax. As an automobile rental agency, tax is not due at the time of the sale of the automobile to the rental agency and taxpayers properly did not pay UT when they purchased the cars to use for rental. Taxpayers are involved in the business of automobile rental as evidenced by their name and actions. By the clear language of the statute, they are obligated to collect the sales tax from their purchasers and have a ROT liability based upon that sale.

Based on the above, I conclude that taxpayers were in the business of renting automobiles and were correctly registered for tax obligations under the ART. As such, I conclude that they were exempt from the imposition of the UT when they purchased the cars for their rental business. Consequently, the interim or demonstration exemption from the imposition of this tax, available to car dealers, has no application in the instant matters.

I also conclude that taxpayers, whose primary businesses are car rentals, are mandated by statute to collect the sales tax from any purchasers of their heretofore rental cars, and remit it to the Department as their ROT obligations. This obligation applies to taxpayers whether they are designated as being in the business of automobile renters or as dealers. Taxpayers attempt to argue a perceived exemption from the imposition of any UT or ROT liability when, in fact, none is found in the law.

Abatement of penalties and interest

Taxpayers assert that an abatement of penalties and interest is warranted in this case. Taxpayers state that the reliance upon their CPA entitles them to an abatement of penalties and interest if the imposition of the tax is upheld. The tax acts that have incorporated the UPIA have a provision for abatement of penalties for reasonable cause. There is no provision for an abatement of interest. Therefore I have no authority to recommend an abatement of interest.

The provision for abatement of penalties found at 35 **ILCS** 735/3-8 states:

> No penalties if reasonable cause exists. The penalties imposed under the provisions of Sections 3-3[10], 3-4[11], and 3-5[12] of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. A taxpayer may protest the imposition of a penalty under Section 3-3, 3-4 or 3-5 on the basis of reasonable cause without protesting the underlying tax liability.

Pursuant to the authority granted by the legislature, the Department has promulgated

[10] 35 **ILCS** 735/3-3; Penalty for failure to file or pay.
[11] 35 **ILCS** 735/3-4; Penalty for failure to file correct information returns.
[12] 35 **ILCS** 735/3-5; Penalty for negligence.

rules interpreting reasonable cause at 86 ILL. Admin. Code ch I, Sec. 700.400. It states:

* * *

> b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.
>
> c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.
>
> d) The Department will also consider a taxpayer's filing history in determining whether the taxpayer acted in good faith in determining and paying his tax liability. Isolated computational or transcriptional errors will not generally indicate a lack of good faith in the preparation of a taxpayer's return.

While taxpayers are correct that the reliance on a tax professional may be a reason for abatement of penalties, it is not appropriate in this case. At his discovery deposition, taxpayers' CPA testified that taxpayers were in the car rental business. (Taxpayers' Ex. No. 1, p. 7) He also testified that taxpayers owed tax on the repair parts at issue. (Taxpayers' Ex. No. 1, p. 16) While taxpayers may have hired a CPA to do their tax work, I see no evidence of reliance on the advice of a tax professional in this matter. I also do not believe taxpayers exercised ordinary business care and prudence in managing the tax obligations for the taxable periods at issue. Taxpayers purchased automobiles without paying sales tax pursuant to the exemption for automobiles purchased for rental purposes. Taxpayers either did not check to see if the trucks,

trailers, and repair parts are included in the statutory exemption or deliberately avoided paying taxes on those purchases.

Further, taxpayers' failure to pay ROT based upon their sales of motor vehicles is totally without statutory support, and, in fact, taxpayers' ROT obligation is mandated regardless of how they characterize themselves. Taxpayers are using a strained reading of the statutes to attempt to avoid paying the taxes at issue. The law is clear in this area and nothing has been offered as a reasonable cause for an abatement of penalties. It is therefore recommended that the penalties at issue be upheld in their entirety.

Taxpayers are entitled to credit for taxes paid by customers

The last issue relates to the invoices supplied to taxpayer during these administrative hearing proceedings. The Department argues that the tax liabilities of taxpayers as listed on the global exceptions are the liabilities of taxpayers alone. Under the ROTA, the retailers are the persons who are required to pay the tax. While the retailer is the entity under the law that is required to pay the tax, a retailer can satisfy his burden and reimburse himself by passing on the burden of the tax to the purchaser by remitting use tax he is required to collect on the purchase. 35 **ILCS** 105/3-45; Brown's Furniture, Inc. v. Wagner, 171 Ill.2d 410 (1996) The invoices supplied evidence that revenue was received by the Department for use tax that was paid by purchasers on some of the vehicles at issue sold by ABC, ABC II, and ABC III. This was done when the customer registered that vehicle with the Secretary of State of Illinois. If the same tax is paid on the same transaction by two taxpayers, double taxation on that transaction occurs, a circumstance to be avoided as addressed by the courts in Illinois Road Equipment, *supra*, L&L, *supra,* and Weaver-Yemm, *supra*. As the courts have frequently and consistently stated, "double taxation does not serve the purpose of the Use Tax Act and is to be avoided." Weaver-Yemm at 86-87, Illinois Road at 580-580, and L & L at 330. It is therefore recommended that taxpayers be given a credit of $21,626.28 against the liabilities imposed herein.

It is therefore recommended that that the Notices of Tax Liability be upheld in their entirety with a credit given for taxes paid by taxpayers' customers.

Respectfully Submitted,

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Barbara S. Rowe
Administrative Law Judge

Date: June 10, 2002